DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 02-0278
Financial Institutions Tax
For the Year 1992-1998

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ISSUES

I. Financial Institutions Tax—Statute of Limitations

Authority: Ind. Code § 6-8.1-5-2; *Phoenix Coal Co. v. Comm'r*, 231 F.2d 420 (2d Cir. 1956)

Taxpayer protests the assessment of additional tax for certain taxable years, based on the assessments being made in an untimely manner.

II. Financial Institutions Tax--Unitary Filing and Economic Nexus

Authority: Ind. Code § 6-5.5-1-18; *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992); *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983); *Exxon Corp. v. Dep't of Revenue of Wisconsin*, 447 U.S. 207 (1980).

Taxpayer protests the inclusion of three subsidiaries as part of Taxpayer's unitary group based on economic nexus.

III. Financial Institutions Tax—Apportionment Factors

Authority: Ind. Code § 6-5.5-2-4; *Citicorp North America Inc. v. Franchise Tax Bd.*, 100 Cal. Rptr. 2d 509 (Cal. Ct. App. 1st Dist. 2000).

Taxpayer protests the inclusion of the receipts from Indiana credit card holders in Taxpayer's receipts numerator for determining apportionment

IV. Tax Administration--Negligence Penalty

Authority: Ind. Code 6-8.1-10-2.1; 45 IAC 15-11-2

Taxpayer protests the assessment of a negligence penalty.

STATEMENT OF FACTS

Taxpayer consists of a number of corporations engaged in varying businesses. One of Taxpayer's subsidiaries, Sub P, filed Financial Institutions Tax returns for 1992 to 1998. Two other subsidiaries, Sub C and Sub L, filed regular Corporate Income Tax returns for 1994 to 1997. After a merger between Sub C and Sub L, the successor company, Sub F, filed corporate income tax returns for part of 1997 and 1998.

In addition to the various banking activities that they may have been engaged in, Sub D and Sub B were in the credit card business at various points during the years in question. Sub D and Sub B had credit cards issued to Indiana customers; however, Sub D and Sub B did not have property in Indiana, and they did not have any payroll in Indiana. Further, any solicitation of credit cards was done by telephone or by United States Mail. Sub H was a company that held and managed an investment portfolio and did not otherwise have any other apparent activities.

The Department audited Taxpayer for the years in question. As a result of the Department audit, it was determined that the various subsidiaries of Taxpayer should have properly filed a combined Financial Institutions Tax return for each of the years in question. As a result, Taxpayer was assessed additional tax, interest, and penalty. Taxpayer protested the assessments, and a hearing was held.

I. Financial Institutions Tax—Statute of Limitations

DISCUSSION

Taxpayer's first argument is that the statute of limitations for assessment of additional taxes passed prior to the Department's assessment. In particular, Taxpayer argues that it waived the statute of limitations only for tax years 1996 and 1997; however, for 1992 to 1995, it did not waive the statute of limitations.

In general, a three-year statute of limitations from the later of the due date of the return or the actual filing date of the return applies for all listed taxes. Ind. Code § 6-8.1-5-2. However, if a person's income is understated by at least twenty-five percent, the statute of limitations is extended to six years. If a taxpayer fails to file a return, no statute of limitations for assessment exists.

For the years from 1992 to 1995, Taxpayer filed separate returns for Sub P. It filed regular corporate income tax returns for Sub C and Sub L in 1994 and 1995. The period for assessing income taxes with respect to these entities started with the timely filed returns, and the time was not tolled by agreement between Taxpayer and the Department. Therefore, Taxpayer has provided sufficient information to conclude that the assessments were untimely with respect to Sub P, Sub C, and Sub L for the years in which they filed returns.

However, based on the information provided by Taxpayer, Taxpayer had a net operating loss carryforward from prior years. While Indiana statutes and case law have not dealt

with this particular situation, federal law governing net operating losses has dealt with this situation. In *Phoenix Coal Co. v. Comm'r*, 231 F.2d 420 (2d Cir. 1956), a corporation incurred a net operating loss in 1947. The corporation carried back its net operating losses to eliminate its 1945 income and reduce its 1946 income. The corporation incurred a further net operating loss in 1948, which served to eliminate its 1946 income.

The Commissioner reviewed the corporation's returns. Upon review of the corporation's returns, the Commissioner determined that the corporation had underreported its 1945 income. Accordingly, the Commissioner redetermined the amount of net operating losses that could be carried forward to 1946, and assessed additional tax for that year. At the time of the assessment, the statute of limitations for imposition of additional tax for 1945 had passed, though not for 1946. The court held that, though taxes for 1945 could not be assessed due to the passing of the statute of limitations, the income for 1945 could be redetermined to compute the proper amount of net operating losses allowable for 1946. *Id.* at 421-422.

The Department can revisit the determinations of the proper amount of net operating losses, along with carryforwards, for the prior audit period and any previous years solely for purposes of determining the proper amount of income subject to tax for years not subject to the statute of limitations, just as the Commissioner in *Phoenix Coal* recomputed the corporation's income for 1945 to determine the proper income for 1946. This does not permit assessment for Sub P for any year prior to 1996 or for Sub C and Sub L for 1994 and 1995, just as the Commissioner's redetermination for 1945 did not permit assessment for that year. Thus, the Department can redetermine the net operating loss carryforwards available for the years in question by combining all Taxpayer's entities into one return. However, the Department cannot assess tax for 1992 to 1995 against Sub P or for 1994 and 1995 against Sub C and Sub L by virtue of the newly combined return.

Further, with respect to Sub B, Sub D, and Sub H, these entities did not file Indiana returns for the period from 1992 to 1995. Also, Sub C and Sub L did not file Indiana returns for 1992 and 1993. The Department is not precluded from making assessments with respect to these entities per Ind. Code § 6-8.1-5-2(e). However, the remedial measures may not result in inconsistent results (e.g., the combination of the unfilled entities creating an assessment, then using the same entities to disallow Sub P's net operating losses).

FINDING

Taxpayer's protest is sustained in part and denied in part.

II. Financial Institutions Tax--Unitary filing

DISCUSSION

Taxpayer's second argument is that the financial institutions tax is unconstitutional as applied to Sub B, Sub D, and Sub H under the Commerce Clause of the United States Constitution. Taxpayer cites to *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). Taxpayer argues that, because the only contacts Sub B, Sub D, and Sub H had with Indiana were Sub B and Sub D's credit cards and solicitation of credit cards, it did not have sufficient nexus with Indiana to permit taxation. Taxpayer urges the rejection of economic nexus as a basis for imposition of Financial Institutions Tax.

However, the issue here is one of a unitary business, rather than one of nexus. First, Taxpayer has not provided sufficient information to conclude that it was not a unitary business as defined in Ind. Code § 6-5.5-1-18 (amended effective January 1, 1999). For the years in question, the presence of a unitary business was sufficient to impose taxation, rather than the presence of a unitary business plus transacting business in Indiana (the test before 1992 and after 1998).

Second, in the case of a unitary business, entities that are considered to be transacting business in a given state in sense of having property, payroll, and sales in that state, as well as other entities that are not transacting business in that state, are considered to be one large business. *See Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983) (unitary filing held to permit subsidiaries doing business outside the United States to be combined on a California corporate tax return); *Exxon Corp. v. Dep't of Revenue of Wisconsin*, 447 U.S. 207 (1980) (though company only had marketing activities in Wisconsin, its other activities conducted outside Wisconsin were part of a unitary business, and thus combining the subsidiaries engaged in the other activities was permissible). The unitary business does not consist of individual entities operating separately; it is a large, interdependent group with varying roles for individual entities. Accordingly, nexus concerns with respect to certain entities are not relevant for unitary analysis; the only concern is whether the businesses are part of one large enterpris, and whether Indiana is taxing its apportioned share of the income of the larger entity. Taxpayer was properly assessed tax on its proportion of Indiana receipts to overall receipts of the overall entity.

Third, even if the issue of nexus was relevant for Sub B, Sub H, and Sub D, Sub B and Sub D conducted their credit card business with Indiana customers at various times during the audit period. By doing so, Taxpayer has sought the benefit of Indiana laws and the business environment that Indiana provides for Taxpayer and Taxpayer's customers. Accordingly, Sub B and Sub D conducted the business of a financial institution in Indiana, and were properly subject to tax during those periods in which they had credit card customers in Indiana.

FINDING

Taxpayer's protest is denied.

III. Financial Institutions Tax—Apportionment Factors

DISCUSSION

Taxpayer argues that only certain members of its unitary group should be included in determining Taxpayer's numerator for apportionment purposes; however, all members of the unitary group, including those that Taxpayer has stated did not conduct business in Indiana, should be included in the denominator.

Under Ind. Code § 6-5.5-2-4:

> For a taxpayer filing a combined return for its unitary group, the group's apportioned income for a taxable year consists of:
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> (1) the aggregate adjusted gross income, from whatever source derived, of the members of the unitary group; multiplied by:
> (2) the quotient of:
> (A) all the receipts of the taxpayer members of the unitary group that are attributable to transacting business in Indiana; divided by
> (B) the receipts of all the members of the unitary group from transacting business in all taxing jurisdictions.

Taxpayer concedes that Sub F, Sub C, Sub L, and Sub P engaged in business in Indiana. However, Taxpayer maintains that the Indiana receipts of its credit card companies, Sub B and Sub D, as well as Sub H should not have been included in the numerator of the sales factor on Taxpayer's combined return, but should have been included in the denominator of the sales factor.

When the Financial Institutions Tax (FIT) was enacted effective January 1, 1990, the FIT originally provided that all income of resident members of a unitary group, plus the apportioned income of the members of a unitary group that transacted the business of a financial institution in Indiana, was subject to Financial Institutions Tax. Thus, a non-resident entity first was required to be a member of a unitary group, and second, the non-resident entity was required to transact business in Indiana.

However, effective in 1992, the scope of taxation was redefined. The scope of taxation was broadened to include unitary entities that did not transact business in Indiana, rather than just those that transacted business in Indiana. Thus, the income of a non-resident entity that did not transact business in Indiana was subject to tax, and the receipts of that entity were added to the denominator of the group's apportionment factor. The scope of the numerator remained the same throughout the period; Indiana could only tax the receipts of the unitary group from Indiana sources. Thus, the term "taxpayer member" (in the numerator) as opposed to "member" (the term in the denominator) was a redundancy that carried over from the 1990 enactment's initial limitations on taxable entities.

Further, while Indiana case law has not addressed the definition of "taxpayer" in a unitary group context when a member had receipts from Indiana but would not have been taxed as a separate entity, California has addressed such a contention in *Citicorp North America Inc. v. Franchise Tax Bd.*, 100 Cal. Rptr. 2d 509 (Cal. Ct. App. 1st Dist. 2000). In that case, Citicorp had several subsidiaries that were taxpayers in California and filed separate returns. Later, Citicorp amended its returns to file as a unitary group. Citibank, a subsidiary included on the unitary return, was not a separate taxpayer for California purposes and had no property or payroll in California. However, Citibank had credit cardholders in California. The issue was whether Citibank's credit card receipts from California cardholders were required to be included in the Citicorp unitary group's sales numerator. The court held that the Citibank's credit card receipts from California cardholders were properly includible in Citicorp's sales numerator for apportionment purposes. In so ruling, the court held that "taxpayer" meant the entire unitary group, rather than just the individual members of the group. *Id.* at 521.

Assuming *arguendo* that Sub B and Sub D were not subject to taxation based on mere solicitation activities, they were still conducting a credit card business in Indiana. Sub B and Sub D were part of a unitary business that included other members of Taxpayer's group. Accordingly, just as the term "taxpayer" in *Citicorp* included a company transacting a credit card business in California when the credit card company was not taxable on a separate company basis, the term "taxpayer member" includes all members of Taxpayer's unitary group transacting business in Indiana, not just those that would have been subject to tax on a separate company basis.

FINDING

Taxpayer's protest is denied.

V. Tax Administration--Negligence Penalty

DISCUSSION

Taxpayer protests the imposition of the ten percent negligence penalty for all taxes that the Department has imposed.

Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC 6-8.1-10-2.1. The Indiana Administrative Code, 45 IAC 15-11-2, further provides:

> (b) "Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as

> negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.
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> (c) The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:
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> (1) the nature of the tax involved;
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> (2) judicial precedents set by Indiana courts;
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> (3) judicial precedents established in jurisdictions outside Indiana;
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> (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
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> (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.
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> Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

With respect to this assessment, Indiana's statutes and regulations were clear with respect to the scope of Financial Institutions Tax. Notwithstanding the statutes and regulations, Taxpayer assumed a position contrary to those statutes and regulations. Accordingly, Taxpayer has not provided sufficient information to conclude that penalty waiver is justified.

FINDING

Taxpayer's protest is denied.

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